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No. 355

In the Supreme Court of the United States

October Term, 1931

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In the Supreme Court of the United States

OCTOBER TERM, 1931

No. —

FRANK COLLIS BOWERS, AS EXECUTOR OF THE ESTATE of Frank K. Bowers, Formerly United States Collector of Internal Revenue, Deceased, petitioner

v.

LAWYERS MORTGAGE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of Frank Collis Bowers, as Executor of the Estate of Frank K. Bowers, formerly United States Collector of Internal Revenue, deceased, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in this case June 8, 1931 (R. 151), affirming the judgment of the District Court for the Southern District of New York (R. 10–11).

QUESTION PRESENTED

Whether the respondent, a corporation engaged in the business of making mortgage loans and thereafter selling such loans under its "policy of mortgage guaranty," was an "insurance company subject to the tax imposed by section * * * 246" of the Revenue Act of 1921, and therefore not taxable under Sections 230 and 1000 of that Act.

STATUTES INVOLVED

These are set forth in the Appendix, pp. 17–18, *infra*.

STATEMENT

The respondent, a New York corporation, voluntarily paid the capital-stock tax imposed upon domestic corporations by Section 1000 (a) (1) of the Revenue Act of 1921, p. 17, *infra*, for the fiscal years ending June 30, 1923, and June 30, 1924. (R. 20, 41–42.) Subsequently it filed claims for refund of such taxes on the ground that it was an "insurance company" and therefore liable for only the tax imposed by Section 246 of that Act. (R. 20, 21, 42, 75.) These claims were denied (R. 21, 43), whereupon the respondent brought this suit in the District Court (R. 3–6). A jury was waived in writing and the cause tried upon stipulated facts. (R. 17–32.)

The respondent is a corporation organized in 1893 under Article V of the Insurance Law of New York relating to title and credit guaranty cor-

porations. (Laws 1892, c. 690.) As such it has been, and now is, subject to supervision by the State Superintendent of Insurance, to whom it makes annual reports. (R. 18, 19, 39–40, 41.)

The respondent has never issued policies of title insurance, although authorized to do so. (R. 22, 44.) Its business was and is carried on as follows: It receives applications for loans secured by first mortgages on real estate. On receiving such an application it causes an appraisal of the security to be made. If the report of the appraisers is satisfactory the application is turned over to a title insurance company, which issues a report on the title and, after the loan is closed, delivers a policy of title insurance. Upon closing a loan the applicant executes a bond and mortgage to the respondent and in return receives the face amount of the loan less charges for the services rendered and for recording, and less a lending fee, which includes the appraisal charge and which constitutes part of the respondent's gross income. (R. 22–24, 44–46.) Thereafter the bonds and mortgages, or certificates of participation therein, are sold or assigned to investors, ostensibly at their face value. When a bond and mortgage are sold, respondent delivers to the investor an assignable "policy of mortgage guaranty." (R. 46–47; Exhibit T, R. 120–127.) In the case of the sale of a participation certificate (R. 47–48; Exhibit U, R. 128–132) there is incorporated in the certificate itself terms corresponding substantially with those in the "policy."

By the "policy," or participation certificate, the purchaser or investor appoints the respondent as his agent to collect the principal and interest on the bond and mortgage (by suit if necessary, but without expense to the purchaser), to keep the title guaranteed to the amount of the mortgage, to keep the mortgaged premises insured against fire, and to require the owner thereof to pay all taxes, assessments, water rates, and fire insurance premiums. The respondent guarantees payment of the principal as and when collected, but in any event within eighteen months after demand in writing by the purchaser after maturity, and payment of interest at a specified rate, which is usually one-half of one per centum less than the rate specified in the bond. This difference, called a "premium," is retained by respondent, and constitutes the consideration for the sale of the mortgage and its accompanying policy or the certificate. (R. 24–26, 120–132.)

In a few cases, constituting only a small percentage of its total business, the respondent issues similar policies to holders of outstanding mortgages not sold by the respondent. (R. 26–27, 48–49.)

The respondent does not make loans for its own investment primarily, but for the purpose of ultimate sale to the general public. In making assignments of bonds and mortgages or of fractional certificates, the respondent always enters into the guaranty described. (R. 28, 50.) The average

length of time between the making of loans and their subsequent transfer to investors is not shown. The interest earned in this intervening period is part of respondent's gross income. Upon renewals of loans extension fees are charged at the generally prevailing rates. (R. 29, 50.)

The sources and amounts of respondent's income in 1922 and 1923 were as follows (R. 29, 51; Exhibit M, R. 77):

Year	Fees (lending and extension)	Interest	Total fees and interest	Premiums
1922	$869,587.26	$372,795.12	$1,242,382.38	$619,986.38
1923	1,064,601.08	426,842.31	1,491,443.39	750,803.21

In conducting its business, the respondent did not segregate its assets, but used them indiscriminately in all its activities. It always kept on hand a sufficient quantity of its bonds and mortgages to maintain the guaranty fund supposedly required by Article V of the New York Insurance Law. (R. 31–32, 53.)

By the law of New York corporations organized under its banking statutes and subject to supervision by the State Banking Department may be authorized to do a mortgage guaranty business substantially like that of the respondent, and at least two companies thus organized and supervised have been and are now so engaged. (R. 29–30, 35, 51.)

The District Court held that the respondent was an "insurance company" within the meaning of Section 246 of the Revenue Act of 1921 and directed

judgment in favor of respondent. (R. 54.) Upon appeal to the Circuit Court of Appeals the judgment was affirmed, one judge dissenting. (R. 146–151.)

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding that the respondent was taxable as an "insurance company" under Section 246 of the Revenue Act of 1921.

2. The Circuit Court of Appeals erred in not holding that the respondent was taxable under Sections 230 and 1000 of the Revenue Act of 1921.

REASONS FOR GRANTING THE WRIT

1. The issue involved in the instant case is of unusual importance in the administration of the tax laws. All the Revenue Acts, beginning with the Act of 1921, make special provision for the taxation of insurance companies.[1] Although the instant case arises under the capital-stock tax provisions of the 1921 Act, which are now repealed,[2] the question presented, broadly speaking, is whether mortgage guaranty companies are taxable as insurance companies or as ordinary commercial corporations. So considered, the question is one which arises un-

[1] See Section 246 of the Revenue Act of 1921, c. 136, 42 Stat. 262; Section 246 of the Revenue Act of 1924, c. 234, 43 Stat. 290; Section 246 of the Revenue Act of 1926, c. 27, 44 Stat. 48; and Section 204 of the Revenue Act of 1928, c. 852, 45 Stat. 844.

[2] See Section 1200 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 125.

der the income-tax provisions of the present law and will be constantly recurring in the absence of a decision by this Court. We believe that a decision by this Court in the instant case will relieve the lower Federal courts of a large amount of litigation.

The question presented in the instant case is now pending in 14 cases before the District Courts, involving an aggregate of $725,000 in taxes, and in 8 cases before the Board of Tax Appeals, involving an aggregate of $84,000 in taxes. The question is presented also in 182 claims for refund now under consideration by the Capital Stock and Income Tax Units of the Bureau of Internal Revenue, aggregating $955,000 in taxes. There are 177 similar cases before these units in which formal claims for refund have not yet been filed, in which cases the total amount of taxes involved is approximately $650,000.

2. In its broader aspects, the question involved arises in connection with the stamp tax laid upon "corporate securities."[3] Mortgage guaranty companies have contended that their participation certificates are not "corporate securities," but contracts of insurance, and hence not subject to the stamp tax. In *Mortgage Guarantee Co.* v. *Welch*, 38 F. (2d) 184 (C. C. A. 9th), certiorari denied, 281 U. S. 759, this contention was overruled, but a con-

[3] See Section 1107, Schedule A (1) of the Revenue Act of 1921, c. 136, 42 Stat. 303; Section 807, Schedule A (1) of the Revenue Act of 1924, c. 234, 43 Stat. 333; Section 807, Schedule A (1) of the Revenue Act of 1926, c. 27, 44 Stat. 101.

siderable number of similar suits are now pending. It seems clear that the decision in the instant case has an important bearing on these cases.

3. Although there is no conflict of decisions in the Circuit Courts of Appeals, considerable diversity of judicial opinion exists. The issue involved in the instant case has been passed upon in *Home Title Ins. Co.* v. *United States*, 41 F. (2d) 793 (E. D. N. Y.), 50 F. (2d) 107 (C. C. A. 2d), in which case the Government is filing a petition for certiorari simultaneously herewith; *Louisville Title Co.* v. *Lucas*, 27 F. (2d) 413 (W. D. Ky.), and *Title Guarantee & Trust Co.* v. *United States*, 49 F. (2d) 641 (S. D. Cal.). In all these cases the District Courts held mortgage guarantee companies doing business in substantially the same manner as the respondent to be taxable as ordinary commercial corporations and not as insurance companies.

4. We believe that the Circuit Court of Appeals misinterpreted the scope and effect of the decision of this Court in *United States* v. *Loan & Bldg. Co.*, 278 U. S. 55, and failed to realize the application to the instant case of the decisions of this Court in *Burk-Waggoner Oil Assn.* v. *Hopkins*, 269 U. S. 110, and *Weiss* v. *Wiener*, 279 U. S. 333.

Wherefore, it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.

SEPTEMBER, 1931.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the District Court (R. 33–38) is reported in 34 F. (2d) 504. The opinion of the Circuit Court of Appeals (R. 146–151) is reported in 50 F. (2d) 104.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 8, 1931. (R. 151.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED, STATUTES INVOLVED, ETC.

A statement of the question presented, specification of errors to be urged, and a statement of the case will be found in the petition. The statutes involved are set out in the Appendix, pp. 17–18, *infra*.

ARGUMENT

By Section 246 of the Revenue Act of 1921, pp. 17–18, *infra*, Congress provided for the taxation of "insurance companies" on a more favorable basis than that applied to commercial corporations generally. Under familiar rules the limits of such an exception are narrowly construed, and classifi-

cation within those limits will be accorded only to companies clearly entitled thereto.

Although Congress did not undertake to define "insurance companies" it indicated the kind of corporation which should be held taxable as such by defining, in subdivision (b) (1) of Section 246, pp. 17–18, *infra*, the gross income of an insurance company as the "gross amount, earned * * * from investment income and from underwriting income." It is common knowledge that a true insurance company has very little, if any, income which does not fall within either or both of these classes. But in the case of the respondent approximately half its income was derived from *fees for making loans*. (R. 51.) Apparently this income escapes taxation altogether if respondent is held to be an "insurance company" within the meaning of Section 246.

An exemption from taxation is not to be presumed or imputed to Congress in the absence of language admitting of no other interpretation. A substantial part of respondent's income did not arise from the usual and ordinary business of an insurance company, and therefore we submit that the respondent was not entitled to be taxed as an insurance company. As stated by the court in *Title Guarantee & Trust Co.* v. *United States*, 49 F. (2d) 641, 643 (S. D. Cal.), *supra*, in construing Section 246:

> It can not be doubted that Congress, in making an exceptional class of insurance

corporations, intended that the corporations which were so favored in the payment of income tax should belong strictly to the class assigned to them. The corporation here had the option of limiting its business operations and functions to those which are the well-known attributes of insurance writing, but it can not combine with insurance work a variety of other classes of profitable business and claim the exempt status which will result in its being relieved of a considerable tax which it would have to pay were the business other than insurance conducted separately.

Even assuming that the respondent's "Policy of Mortgage Guarantee" amounted to a "contract of insurance," nevertheless we submit that the respondent was not an "insurance company" within the meaning of Section 246. Upon the assumption stated, it performed some insurance business, but its primary business was that of selling mortgages, to which the promises of guaranty were merely incidental or ancillary. The Circuit Court of Appeals reached the opposite conclusion upon the ground that, unlike investment companies generally, respondent's profits did not come from the spread in the purchase and sales price of the bonds and mortgages it sold; that accordingly respondent made the loans and sold the mortgages only for the purpose of creating an opportunity to insure their payment, and that the loan and subsequent sale were merely incidental to the guaranty.

But the fact that the respondent received its profit in the form of periodic payments called "premiums," did not make its business that of insurance rather than that of investment broker. *State* v. *The Federal Investment Co.*, 48 Minn. 110, 111. Moreover, we believe that in essence the respondent did get its profit from the spread in purchase and sale prices. It sold the bonds and mortgages and certificates for more than it paid for them by reducing the amount of interest received by the investor. The practical result to the respondent in the way of profit on the sale of the mortgages was the same as if the sale had been at a premium.

The Government contends that the guaranty was merely one of the terms or conditions of the contract of sale. The fact that the guaranty was, or resembled, a contract of insurance did not change the legal and primary character of the transaction as a sale of the bond and mortgage. A contract of hiring is not changed to one of insurance merely because the employer deducts a portion of the employee's wages and in return agrees to pay the employee for his labor even if the goods upon which the labor is expended are destroyed while in the latter's custody. *Stern* v. *Rosenthal*, 71 Misc. Rep. 422. A business of inspecting and certifying the sanitary condition of buildings is not changed to one of insurance because the company also intends to insure against loss occasioned by bursting pipes, leaking plumbing, etc. *People ex*

rel. Woodward v. *Rosendale,* 142 N. Y. 126. A contract of employment is not changed to one of insurance merely because the employer agrees to protect workmen from injuries by strikers. *Hansen* v. *Dodwell Dock & Warehouse Co.,* 100 Wash. 46. See also *Cole* v. *Haven,* 7 N. W. (Iowa, 1880) 383; *Evans & Tate* v. *Premier Refining Company,* 31 Ga. App. 303. We believe that what respondent was doing was selling mortgages, and that the guaranty was merely an incident of such transaction of sale.

Insurance companies, as commonly known, assume risks to which others are exposed; they do not create risks to be thereafter insured. In the instant case the respondent bears the risk both before and after the issuance of its "policy of mortgage guaranty." The party "insured" never has it. The insurance which the respondent asserts it provides does not involve the shifting of risks which is present in insurance business as commonly known.

The Government contends further that the respondent's promise of guaranty is not a contract of insurance but a contract of guaranty, similar to that of a guarantor of a promissory note. Without attempting to enumerate all differing incidents of the two, it is true generally that a contract of insurance is an independent and direct, personal undertaking, collateral to no other contract, whereas in a contract of guaranty the covenant is collateral

to another contract and dependent thereon. The respondent's undertaking upon the sale of its mortgages is not independent of but is collateral to the mortgagor's obligation. Its liability to pay under the "policy" is dependent upon the terms of the loan both as to principal and interest; it "guarantees" "payment of interest * * * under the terms of said bond and mortgage," and "payment of the principal sum * * * under the terms of the said bond and mortgage." (R. 120.) Accordingly, we believe that respondent's covenant is a pure guaranty and not a contract of insurance.

The conclusion of the Circuit Court of Appeals that the respondent was an insurance company within the meaning of Section 246 was apparently predicated partly upon the decision of this Court in *United States* v. *Loan & Bldg. Co.*, 278 U. S. 55, and the fact that respondent was organized and operated under the Insurance Law of New York.[4] It is true that the corporation involved in the *Loan & Bldg. Co.* case was held to be a "building and loan association" partly because it was organized as such under the State laws, but the decision in that case went off on the ground that the taxpayer was commonly known as a building and loan asso-

[4] This argument was advanced by the court in *Home Title Ins. Co.* v. *United States*, 50 F. (2d) 107, *supra*, decided the same day as the instant case, and involving a mortgage guaranty company organized and doing business substantially in the same manner as the respondent.

ciation (p. 58). Here the situation is radically different, since companies of respondent's type are not commonly recognized as insurance companies. The respondent did not even attempt to pose as such before the public. Its 1925 report to the Superintendent of Insurance and its advertising by means of so-called "radio talks" show unmistakably that it was holding itself out and was commonly known as an investment company. (R. 78–80.)

Furthermore, the taxpayer in the *Loan & Bldg. Co.* case could operate only under the Ohio building and loan laws, whereas here the respondent could have been organized under the *banking laws* of New York and have pursued substantially the same business. (R. 29–30.) If the form of organization under the New York laws is held to be controlling, the result would be that respondent would be taxable under Section 246, while some of its competitors would be taxable on a more onerous basis as ordinary commercial corporations. We do not believe that the *Loan & Bldg. Co.* case was intended to limit the doctrine of cases like *Burk-Waggoner Oil Assn.* v. *Hopkins,* 269 U. S. 110, 114, and *Weiss* v. *Wiener,* 279 U. S. 333, 337, which hold that the power of the Congress to classify persons or property for purposes of taxation is not limited by their treatment under local law, nor is its power to apply its own tests and criteria in determining taxable status. Clearly Section 246 was not intended

to embrace every organization a State might for reasons of its own be content to supervise under its insurance laws.

CONCLUSION

We submit that the decision of the Circuit Court of Appeals is erroneous. The question presented is one of general importance in the administration of the laws and is raised in a large number of cases pending in the courts and the Bureau of Internal Revenue. Several District Courts have reached a conclusion contrary to that of the courts below. We respectfully submit that the petition should be granted.

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SEPTEMBER, 1931.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 252, 262, 294.

CAPITAL STOCK TAX

SEC. 1000 (a) That on and after July 1, 1922, in lieu of the tax imposed by section 1000 of the Revenue Act of 1918—

(1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of $5,000. In estimating the value of capital stock the surplus and undivided profits shall be included;

* * * * *

(b) The taxes imposed by this section shall not apply * * * to any insurance company subject to the tax imposed by section * * * 246.

TAXES ON INSURANCE COMPANIES

SEC. 246. (a) That, in lieu of the taxes imposed by sections 230 and 1000, there shall be levied, collected and paid for the calendar year 1922, and for each taxable year thereafter, upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company the same percentage of its net income as is imposed upon other corporations by section 230;

* * * * *

(b) In the case of an insurance company subject to the tax imposed by this section—

(1) The term "gross income" means the combined gross amount, earned during the

taxable year, from investment income and from underwriting income as provided in this subdivision, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners;

(2) The term "net income" means the gross income as defined in paragraph (1) of this subdivision less the deductions allowed by section 247;

(3) The term "investment income" means the gross amount of income earned during the taxable year from interest, dividends and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) The term "underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

TAX ON CORPORATIONS

SEC. 230. That, in lieu of the tax imposed by section 230 of the Revenue Act of 1918, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

(a) For the calendar year 1921, 10 per centum of the amount of the net income in excess of the credits provided in section 236; and

(b) For each calendar year thereafter, 12½ per centum of such excess amount.

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